

Office of the  
**Consumers' Counsel**



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MAY 4 1994

May 4, 1994

William F. Caton, Acting Secretary  
Federal Communications Commission  
1919 M Street, NW  
Room 222  
Washington, D.C. 20554

Re: Docket No. 94-1

Dear Mr. Caton:

Enclosed please find an original and nine (9) copies of The Office of the Consumers' Counsel, State of Ohio, Comments for filing with the Commission in the above-referenced proceeding.

Please indicate your receipt of this filing on the additional copy provided and return to the undersigned in the enclosed self-addressed, postage prepaid, envelope. Thank you.

Sincerely,

David C. Bergmann  
Associate Consumers' Counsel

DCB/pjm

Enclosures

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**Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D. C. 20554**

In the Matter of	)	
	)	
Price Cap Performance Review	)	CC Docket No. 94-1
for Local Exchange Carriers	)	

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**COMMENTS OF  
THE OFFICE OF THE CONSUMERS' COUNSEL,  
STATE OF OHIO**

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**I. STATEMENT OF INTEREST / SUMMARY OF POSITION**

The Office of the Consumers' Counsel, State of Ohio (OCCO), is the statutory representative of residential utility consumers in the State of Ohio. See Ohio Revised Code Chapter 4911. OCCO represents the residential customers of the many inter-exchange carriers (IXCs) which purchase access services from Ohio Bell Telephone Company/Ameritech Ohio (OBT), United Telephone Company of Ohio, and GTE North, Inc., which are local exchange companies (LECs) subject to the price cap regime at issue here.<sup>1</sup> OCCO was a commenter, alone and with others, in the FCC's original price cap proceedings.

OCCO's clients are impacted by the operation of price caps on the interstate level. On the intrastate level, in Ohio most

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1. OCC also represents the Ohio residential customers of AT&T, which is affected by the LEC price cap regime but also has its own price cap regime.

intrastate access charges mirror the interstate charges. In the end, of course, the end-user picks up those costs, and residential customers have the fewest effective options for long distance service. Thus OCCO's clients are precisely those for whom it is most important that the price caps regime acts as an effective surrogate for competition.

OCCO was among the many parties who opposed the adoption of price caps by the Commission when it was originally proposed and implemented. There was little real evidence then to support either the need for or the purported benefits of price caps.

At this point in time, three years after the effective date of the LEC price caps, the benefits of price caps should be an objectively provable proposition. Only by specifically addressing and assessing those benefits can this Commission judge whether 1) to substantially alter the formula and other terms of price caps; or 2) to add additional goals and objectives to the price cap regime.

With regard to the latter subject, the goal for which the price caps were adopted was to replicate the marketplace forces of competition more effectively than rate of return regulation was thought to. Notice of Proposed Rulemaking ("NOPR") at ¶11-12. OCCO submits that the evidence does not show that price caps have done a better job of replicating a truly competitive marketplace than traditional regulation. There indeed have been significant access charge reductions under the regime. See Telecommunications Reports, April 6, 1992 (at 30);

April 12, 1993 (at 4-5); and April 4, 1994 (at 22-23). What is missing from this equation, though, is any notion of what rates would have been under an effectively administered rate of return regime. Without such a showing, there is no proof that price caps are working better than traditional regulation would have; such proof is necessary to conclude that the price cap system is working. See Telecommunications Reports (April 11, 1994) at 11.

Apart from the comparison to traditional regulation, if the goal is to push prices closer to cost, as would be the case in a truly competitive market, we also have little basis on which to draw conclusions about the difference between the price cap rate reductions and those which might obtain in a competitive market. Given the profit levels of the LECs, despite the continuing access charge reductions, and the fact that apparently no LEC has had to take advantage of the "low-end" adjustment mechanism (NOPR at ¶17), there appears to remain considerable slack between the price cap reductions and actual declines in cost. If price caps are to be maintained, they must be revised to provide additional end-user benefits, through further restraints and reductions to access charges.<sup>2</sup>

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2. The primary beneficiaries of price caps appear to be the LECs, which have enjoyed a steady diet of higher profits. NOPR at ¶26. (Of course, the evidence also suggests that the IXCs as a group are doing quite well, leaving the clear impression that whatever is going on, end-users are missing out on much of the benefits of the changes in regulation.)

And with regard to whether the price caps regime should be altered to specifically assist other national goals such as infrastructure development and economic growth (NOPR at ¶36), OCCO submits that absent a demonstration that price caps have satisfied their initial goal, it is entirely inappropriate to add additional qualifications to the program. Such additions will even further obscure whether price caps have achieved their fundamental free market goals.<sup>3</sup>

OCCO will address a number of the NOPR's questions based on broad policy themes and the limited evidence which is before us. OCCO expects to file more extensive reply comments, based on the expected submission of information by those who should have the facts at hand to demonstrate the benefits of price caps.<sup>4</sup>

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3. It is widely claimed that the increasingly competitive market cannot afford subsidies, such as those equally widely claimed to benefit residential consumers. If these propositions are true, surely the system cannot afford additional subsidies such as those created by policies that supplant the free choices of a competitive market in the interest of infrastructure and particular sectors of development.
  4. OCCO will not reargue here whether price caps themselves are appropriate on the interstate level. This should not be seen as any concession that price caps are appropriate for the LECs' intrastate service. That issue is currently before the Public Utilities Commission of Ohio (PUCO) in an Ohio Bell case, PUCO Case No. 93-487-TP-ALT.

## **II. GENERAL ISSUES**

**General Issue 1:** Should the Commission revise the goals of the LEC price cap plan so that the plan may better achieve the purposes of the Communications Act and the public interest, and if so what should be the revised goals?

**RESPONSE:** The Commission's objective here should be to revise the LEC price caps plan so that the plan may more effectively achieve the goal originally set for the plan, at least in the absence of strong evidence that the plan has been successful in meeting that goal.

The Commission's brief discussion of "LEC Performance Under Price Caps" (NOPR at ¶25-31) shows that the LECs are by and large pricing at the cap or not substantially below it. Id. at ¶25. Although it may be that overall inflation in the economy has been 11.6% (id.), key inputs for the LECs have decreased at a faster rate than LEC access prices. Id. at ¶44. This suggests that the price cap plan is a price support, not a limit on any price increase that would have occurred under traditional regulation.

## **III. BASELINE ISSUES**

**Baseline Issue 1a:** Whether, and if so how, the Commission should revise the LEC price cap plan to support the development of a ubiquitous national information infrastructure.

**RESPONSE:** As the Commission well knows, it is currently engaged in a number of other proceedings with direct impact on the deployment of an advanced telecommunications infrastructure. NOPR at ¶20. Those proceedings should be allowed to proceed independently.

The price cap plan is designed to bring a competitive discipline to access prices. Explicit recognition within this plan of goals other than competitive constraints on prices within this plan will minimize the chance of reaching the original goal, by allowing consideration of non-price factors in the setting of access charges.

**Baseline Issue 1b:** Whether the goal of providing universal service to all geographic areas and of equal type and quality for all Americans at affordable prices is being met, or whether we should revise the LEC price cap plan to ensure the provision of universal service.

**RESPONSE:** Like the infrastructure development issue just discussed, there are also a number of ongoing proceedings concerning universal service. It is equally appropriate to keep those issues separate from the price cap plan, especially given the lack of consensus over what universal service is, should be, or will be.

Indeed, under economic theory the best incentive for universal service (however it may be defined) for price cap LECs (which tend not to be high-cost operations, and whose costs continue to decline) is a regime which does in fact most closely replicate a competitive market. OCCO submits that the price cap plan, if maintained, should be allowed to do its work.

**Baseline Issue 3a:** Whether the productivity factor used to compute the LEC price cap indices should be changed; in addition, or in the alternative, whether a one-time change in the LEC's price cap index should be required. If a rate reduction were required, commenters should discuss how such a reduction should be distributed among price cap baskets and service categories. As a further alternative, whether the Commission should adopt a mechanism which would adjust the plan to reflect changes in interest rates. Commenters should discuss how such a mechanism would operate, including, for example, what deviations in interest rates would trigger the adjustment mechanism. Commenters should address how the option they advocate would preserve or improve price cap incentives and assure just and reasonable rates.

**RESPONSE:** The fact that the LECs have experienced higher earnings under price caps (NOPR at ¶44), coupled with the fact that no LEC has needed above-cap rates (id. at ¶25), is an indication of a market that lacks competitive discipline. In such a market, earnings consistently above a firm's cost of capital are economically inefficient.

Thus it is entirely appropriate for the Commission to adjust the price cap plan to reduce that inefficiency. The chief means should be an increase in the productivity factor, to further enforce a "surrogate competitive" discipline. A higher price cap productivity factor will enforce the need for increased productivity by the LECs.

It may be that some LECs have earned so far in excess of a reasonable return under the price cap plan that a one-time adjustment in rates is necessary to establish equilibrium prices. (NYNEX comes to mind, see NOPR at ¶44, fn. 55, as does Ameritech.) Such an adjustment may not be needed across the board for all LECs. (However, see footnote 5, infra.).



With regard to recognizing the current level of interest rates in the plan, it almost goes without saying that interest rates are the largest factor in the LECs' cost of capital. To base a price cap formula on four-year-old, much higher, interest rates, allows the LECs to take advantage of general economic conditions having nothing to do with the LECs' productivity or efficiency. The return-related provisions of the price cap plan (see Baseline Issue 4, infra) should be revised to reflect current economic conditions.<sup>5</sup>

**Baseline Issue 3b:** Are the price cap LECs' profits levels reasonable under the current LEC price cap plan in light of the price cap goal that higher profits are intended to be the reward for attaining increased efficiencies?

**RESPONSE:** If the LECs' current profit levels were entirely the result of attaining increased efficiencies, it would be easier (though by no means automatic) to accept these profits as appropriate rewards for that efficiency. As noted above, however, the bulk of the excess of current returns over current interest and cost of capital levels is not a product of the LECs' efficiency, but of a decline in interest rates and other changes in the general economy.

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5. Given that there has been no downward adjustment in the price cap mechanism over the four years of declining interest rates, symmetry demands a similar restraint if rates go up in the future. If an adjustment mechanism is adopted, it must be accompanied by a downward adjustment to current rates to mimic the result of an adjustment mechanism being in effect in previous years.

**Baseline Issue 4a:** Whether the sharing and low-end adjustment mechanisms should be realigned with capital costs, and if so, how should this be done.

**RESPONSE:** See discussion of Baseline Issue 3a, supra.

OCCO submits that the simplest method of realigning the sharing and low-end adjustment mechanisms would be to replicate, under current economic conditions, the calculation that led to the initial 11.25% determination. Then the sharing and low-end adjustment mechanisms should be realigned with that number. (This would maintain a degree of consistency that would allow more effective comparison of the results.)

**Baseline Issue 4b:** Whether the sharing and low-end adjustment mechanisms should be revised or eliminated.

**RESPONSE:** As noted above, OCCO recommends that the mechanisms be adjusted to reflect current economic conditions.<sup>6</sup> With regard to whether the mechanisms should be eliminated, on the one hand there are the LECs complaining that the mechanisms constrain them too much<sup>7</sup>, and on the other

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6. We agree with AT&T (see NOPR at ¶52) that low earnings that are the result of a one-time charge against earnings are not reflective of economic conditions, being merely reflective of accounting choices made by the LECs. See NOPR at ¶64.

7. OCCO notes that eliminating the sharing mechanism "to provide LECs with a greater incentive to invest in the infrastructure because they will have 'an opportunity to maximize the return on shareholder equity over the long run...'" does not avoid the Averch-Johnson problem for these monopoly services. See NOPR at ¶11.

hand MCI claims that the mechanisms do not constrain the LECs enough. NOPR at ¶52. If the changes OCCO has recommended are implemented, we think the mechanism should be given another chance.

**Baseline Issue 6a:** Whether the number of cost changes currently eligible for exogenous treatment under price caps should be reduced.

**Baseline Issue 6b:** If so, which cost changes should be eligible for exogenous treatment under price caps.

**RESPONSE:** These two issues can be treated together: In a competitive market, all cost changes are "endogenous", i.e., economic events that a firm's prices cannot ignore. But the LEC price cap is based on the GDPPI, which is intended to be as inclusive as possible of all relevant inputs. Therefore, OCCO urges the Commission to abandon this conceptually inconsistent LEC assistance mechanism. If the exogenous change mechanism is retained, it should be limited to material factors impacting only the LEC, and not the rest of the industry or the economy. Obviously, such factors will be rare.

**Baseline Issue 6c:** Whether we should adopt an administrative process to allow access customers or other groups to request cost changes eligible for exogenous treatment and, if so, what should be the procedures in such an administrative process?

**RESPONSE:** If exogenous changes remain a part of the price cap plan, then it is vital to add symmetry to the program. As the Commission notes, the LECs "have substantial incentives to report and request exogenous treatment only for those [factors] that might generate increases in the cap, not

those that might justify reductions." NOPR at ¶65. Thus access customers and other groups (such as end-user representatives) should be able to bring downward exogenies to the Commission's attention, under procedures no more onerous than those used by the LECs to request upward adjustments.

**Baseline Issue 7:** Service Quality, Infrastructure Monitoring, and Network Reliability.

As a single initial response to the sub-part of this issue, OCCO submits that, regardless of whatever refinements are made to the reporting requirements, it is essential to make those requirements mean something: Given that one of the initial goals of price caps was to ensure "the availability of high-quality, innovative telecommunications services..." (NOPR at ¶67), and given the inconsistent service record under this regime (id. at ¶27), it is appropriate for the Commission to adopt a mechanism to disincent declining service quality.<sup>8</sup>

**Baseline Issue 11:** Other Revisions to the Current LEC Price Cap Plan.

**RESPONSE:** As OCCO indicated earlier, the issues to be considered in this proceeding should be limited to those with the most direct relevance to the original objectives of the price cap program. There is neither need for nor efficacy in

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8. Improved service quality may not be its own reward, but it clearly leads to a variety of benefits for the LEC. Thus no upward adjustment to reward improved service quality should be necessary.

the introduction of new elements (goals, objectives, or policies) into the price caps mix at this point. The changes OCCO has recommended are consistent with that singleness of purpose; other parties' proposals should be looked at in the same light.

**Baseline Issue 12:** Relationship to Other Proceedings.

**RESPONSE:** OCCO submits that the best way to coordinate the LEC price cap plan with other proceedings and proposals is to keep each of these proceedings focussed on its main objective. Only if there is a clear conflict between objectives (an unlikely result, we believe) should there be intermingling of the cases.

**IV. TRANSITION ISSUES**

**Transition Issues 1-4**

**RESPONSE:** Virtually all parties involved in telecommunications recognize that competition is a growing phenomenon; what we have are continuing (if not continual) debates over the level of current and future competition for virtually every telecommunications service. The Commission must, of course, recognize this reality. However, the Commission must also recognize the limitations of its consideration of competition as to the subject matter of this proceeding: that is, it is competition for interstate access services that should be the Commission's focus here. Competition in other areas of telecommunications is irrelevant to the LEC price cap plan.

As competition for interstate access develops via the growth of alternate local networks, there will be a need to consider changing the applicability or terms of the price cap plan. For the moment, though, it is clear that such competition is insufficient to justify any major change in regulation; regulation continues to be needed as a surrogate for effective competition.<sup>9</sup> Thus at present there is no real need to consider these issues in this context.

**Transition Issue 5:** Frequency of Review under Price Cap Regulation.

It is taken as a given that the pace of change in the telecommunications industry continues to accelerate. Thus it is not appropriate for the Commission to wait another three or four years to again review the LEC price cap plan. OCCO submits that the Commission should commit to reviewing the plan in two years from the date of any changes to the price cap plan implemented in this docket, or even if no changes are made here. In order to facilitate this review, OCCO recommends that, prior to receiving comments on future changes to the plan, the Commission should gather and publish factual information about the impacts of the plan, so that all parties may comment on an equal informational footing. For instance,

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9. For instance, there is clearly far less access competition, and far more of an access monopoly for the LECs, than was seen to justify relaxing AT&T's price cap regulation. See, e.g., NOPR at ¶92.

the information contained in General Issue 1, Baseline Issue 1c, the "evidentiary" portion of Baseline Issue 2, and Transition Issues 1a and 1d, should be the ground for initial comments next time, not just for reply comments.

V. CONCLUSION

OCCO, on behalf of the residential telephone customers in Ohio, welcomes the chance to assist the Commission in improving the LEC price cap plan, in order to enhance the consumer benefits which the plan was supposed to provide. OCCO urges the Commission to focus on that goal, and to not dilute the purpose for which the plan was designed by adding additional goals which are being addressed in other proceedings and other forums.

OCCO submits that the changes proposed here will improve the plan. We look forward to reply to other interested parties' factual submissions and policy proposals.

Respectfully submitted,

ROBERT S. TONGREN  
CONSUMERS' COUNSEL

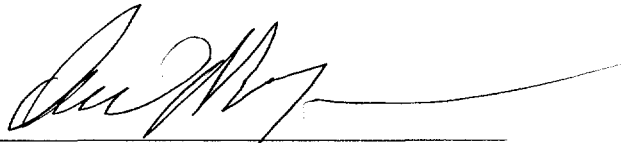


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**CERTIFICATE OF SERVICE**

I hereby certify that copies of the Comments of the Office of the Consumers' Counsel, State of Ohio, were mailed to the Acting Secretary of the Federal Communications Commission, Washington, D.C., 20554 this 4th day of May, 1994.



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**ADDITIONAL COPIES FILED**

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